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SUBJECT: "Paralysis" of GoB's Microeconomic Program

1. A column in the March 5-7 issue of top financial daily 'Valor Economico' summarized pessimists' view that the Diniz scandal and other hurdles have resulted in a semi-breakdown of the legislative progress of the GoB's so-called 'microeconomic' reform measures, which are generally acknowledged as vital to sustain Brazil's future growth. Following is Embassy's unofficial and slightly edited translation of the column by 'Valor' commentator Claudia Safatle.

3. (Begin Text of Unofficial Embassy Translation)

(HEADLINE) Paralysis is Conquering the Government

The Waldomiro Diniz case is one problem. But the government's real problem is a different one: economic growth. This is the grave question to which the government needs to give quick answers, and for this it needs to break out of its paralysis. It is not viable to conduct an economic policy that produces a retraction of 0.2% of the Gross Domestic Product, loss of real income, fall of per capita income, and spectacular growth (in the neighborhood of 140%) in profits of the banking system. Something is wrong.

From the start of the Diniz episode, from February 13 to the present, notwithstanding the political tangles which the government and PT got themselves into trying to manage the revelation of the corruption of Planalto's ex-advisor, the Presidency has held endless meetings of the government's power-nucleus, to try to emerge from paralysis and create a "growth agenda."

In formulating this initiative, the government has taken over from the hands of the bureaucracy, and is now parading, measures to stimulate civil construction, a sector that fell heavily last year (8.6%). Now, the government is attempting to announce on an almost weekly basis measures of a more microeconomic nature to resolve problems that do indeed restrict investments, without which there will be no growth at all. And to make these unveilings into events with maximum impact on public opinion. Among the provisions already ripe to be announced is a new industrial policy for four already-defined sectors: software, pharmaceuticals, capital goods, and semi-conductors.

The resumption of interest rates' downward trajectory is a central part of the problem and here there is a conundrum to resolve: the Central Bank sees robust economic growth as having been underway since last October, with accompanying inflationary pressures. The CB President, Henrique Meirelles, has said that the economy finished 2003 growing at a rate of 1.5% (in the last quarter) which, annualized, would represent an increase in GDP of 6.14% this year. Yesterday, in meetings with market representatives in Sao Paulo, directors of Central Bank reiterated this vision. "People talk as if Brazil were not growing on a current basis because of the minus 0.2% from last year, and as if we will have to strain to grow 3.5% (in 2004). That's not true. It's nonsense. Brazil is growing at an aggressive rate and even if we reduce this rate, we will reach 3.5% growth this year," commented Meirelles to 'Valor'.

As the market sees it, in the first two months of 2004 the level of activity started to go cold and there are no menacing inflationary pressures on the horizon. The great majority of banks and consultants are lowering their estimates of economic growth for this year. Those who expected 4% are now closer to 3%, and there are those who project less than 3%...

There has never been, during the existence of the inflation-target regime established in 1999, as profound a disconnect as now between the Central Bank and the market in their respective assessments of the economic situation...

The difficulties in fostering the growth which in the Central Bank's view is going great guns but as far as the

market is concerned is bogged-down and lacks new investment, don't stop, however, with the COPOM (Central Bank's Monetary Committee.) It is just part of the problem and should not be held responsible for all the nation's ills.

The other part, no less important, has to do with whether or not the country today has a favorable environment for investments. The private sector says the environment is bad, and the government doesn't dispute this view. It even has a list of things to do to improve things. The challenge is to turn this generic list into concrete measures in a quick, effective way.

The new energy model is an example. It took months to construct a proposal, months to negotiate it, and it was approved by Congress just yesterday (March 4). The basic rules for investments in sanitation and water-treatment circulate from hand to hand along Ministry Row. After the government announces the preliminary bill for regulation of this sector, it will be presented for public audience and only after this process will it go to Congress.

The role of the regulatory agencies was the focus of a concept document elaborated at the end of last year by the Civil Household (Casa Civil.). Brought before a public forum, the document received more than 200 suggested amendments. The government promised to transform the document into a bill that would define the exact role of regulatory agencies, but has not mentioned the subject since. The sole bill sent to Congress on this subject had to do with the contracting of employees for Aneel and Anatel (electricity and telecomm regulatory agencies.)

If it doesn't resume these initiatives, the government will end up hurting growth in future years, since this year's is a given...

(End Text of Embassy Translation)

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